RUSSIA

In 1998, the U.S. trade deficit with Russia was $2.1 billion, an increase of $ 1.1 billion from the 1997 deficit of $1.0 billion. U.S. merchandise exports to Russia were $3.6 billion, an increase of $296 million (9.0 percent) from the level of U.S. exports in 1997. Russia was the United States' 32nd largest export market in 1998. U.S. imports from Russia accounted for approximately $5.7 billion in 1998, an increase of $1.4 billion (33.7 percent) from the 1997 imports. The stock of U.S. foreign direct investment in Russia in 1997 was $1.9 billion, an increase of 42.9 percent from 1996.

The U.S.-Russia Trade Agreement governs all trade relations between the United States and Russia. The USSR signed the agreement in June 1990 and it was approved by the U.S. Congress in November 1991. The agreement, however, never reached ratification during the existence of the USSR, but the United States offered the agreement (with minor technical changes) to each of the emerging states of the former Soviet Union. Russia's parliament approved the agreement, making it possible for the United States to extend Most-Favored-Nation (now Normal-Trading Relations or NTR) status to Russia on June 17,1992. Russia is in the process of negotiating terms of accession to the World Trade Organization (WTO).

IMPORT POLICIES

Imposition of Russian import duties, a 20 percent value-added tax charged on most imported goods (selected food products are exempt or assessed at 10 percent), excise taxes assessed on imported goods (especially automobiles, cigarettes, alcoholic beverages, aircraft) and a burdensome import licensing regime for alcohol combine to depress Russian demand for imports. Frequent and unpredictable changes in Russian customs regulations have created problems for foreign and domestic trade and investment. However, at the end of 1998, the most significant barriers to U.S. exports were the result of the difficult economic situation in Russia subsequent to the August 1998 financial crisis. The steep devaluation of the ruble during the second half of 1998 -- itself a product of the financial crisis -- has produced a concomitant contraction in Russian purchasing power. Other significant negative reverberations in the foreign trading environment include the reduced availability of trade and non-trade finance, disruption to the distribution chain, and chronic payment/clearance problems.

Since 1995, Russian tariffs have generally ranged from five to thirty percent, with a trade-weighted average in the range of 13 to 15 percent. In addition, excise and value-added taxes (VAT) are applied to selected imports. The VAT, which is applied to the price of the import plus its tariff, is currently 20 percent with the exception of some food products. In July 1998, the VAT rose 10 to 20 percent for many agricultural goods. In addition, a temporary three-percentage point tariff surcharge on all goods was enacted in August 1998 as a balance of payment and revenue measure, to be effective from August 15, 1998 until the end of 1999. In 1997 and 1998, new combined customs duties (imposing minimum import tariffs) were introduced on various meat products, processed cheese, bottled water, cassettes, leather goods, wall coverings, apparel, mattresses, and manufactured goods such as audio and video.

Financial sector difficulties and the ruble devaluation in September and October 1998 resulted in a sharp decline of food imports. Russia reacted with the announcement of several measures affecting the import of staple food products and inputs used by the food processing industry. These measures include: a cancellation of the three percent surcharge; a rollback of the vat increase; and cuts in customs duties. Importers from the

United States have experienced delays and unexpected costs due to individual interpretation of Russian customs codes by each port of entry.

Russian tariffs that particularly hinder U.S. exports include those on autos (where combined tariffs and engine displacement-weighted excise duties can raise prices of larger U.S.-made passenger cars and sport utility vehicles by over 70 percent), certain semiconductor products, aircraft and some aircraft components (for which tariffs are set at 30 percent), and wood product (tariffs of 20 percent). A Russian resolution made in July 1998, waives aircraft import tariffs for Russian airlines (contingent on those airlines' purchases of Russian-made aircraft). During the course of 1998, tariff waivers were granted to Aeroflot for purchases of foreign aircraft.

Russia maintains high tariffs and excise taxes on imported spirits. In 1997, Russia instituted an extensive regulatory system for alcohol product import and sale. U.S. exports of distilled spirits consequently dropped from USD 23 million in 1996 to only USD 8 million in 1997. The prices of alcohol licenses and annual import license fees were raised in 1998. The annual import license fees were raised to 30 times higher than the corresponding fees for domestic product licenses. U.S. exporters also complained that the strip stamp requirement, used to show that an excise duty has been paid, has not been applied equally to domestic producers and that excise taxation itself is often discriminatory.

On November 1, 1998, the Russian Government began tightening restrictions on the marketing of alcohol by implementing Resolution 1159. The new regulations envisage a state monopoly on the manufacture and state control of the distribution of alcohol over 27 proof. There are numerous local restrictions on the marketing of alcohol, including the prohibition of sale of hard liquor in open air markets in Moscow. In January 1999, a new law on state regulation of alcohol and alcoholic production was signed by the President. The new law establishes new barriers to trade in this sector, including: (1) imports of alcoholic products (other than wine, cognac and brandy, and beer) are to be limited to 10 percent of annual consumption; and (2) the law establishes extremely onerous conditions for obtaining import licenses. This legislation clearly aimed at protecting the domestic industry. The Russian Government also submitted a new draft law to the Duma that would ban the import of ethyl (pure) alcohol for three years in order to increase government revenues from domestic production and to control the quality of product. Trade officials expect speedy passage of this proposed law.

Import licenses are now also required for color tv’s, sugar, leaf tobacco and tobacco products, combat and sporting weapons, self-defense articles, explosives, military and ciphering equipment, encryption software and related equipment, radioactive materials and waste including uranium, strong poisons and narcotics, and precious metals, alloys and stones. Russia is increasingly resorting to "automatic" licensing regimes in an effort to cut down on smuggled imports that evade payment of customs duties and related taxes.

U.S. poultry exports to Russia, which account for over one-third of total U.S. exports of this product, remain somewhat sensitive. In 1998, the Russian poultry industry informally requested initiation of a safeguard action against imported poultry, under Russia's new trade remedies law. However, by the end of 1998, no formal request had been submitted and therefore no case had been initiated.

In early 1997, the Ministry of Communications circulated a regulation entitled Order No. 8, which limits Russian purchases of foreign-made switchgear. The order is ambiguous and may be withdrawn in the future. Until that time, it threatens to restrict access to the Russian market for this equipment. The order forces the 86 regional companies in the Svyazinvest group to give preference to Russian-made digital switching equipment. There is no technical reason for this requirement.

STANDARDS, TESTING, LABELING AND CERTIFICATION

U.S. companies continue to report that Russian procedures for certifying imported products and equipment are non-transparent, expensive, and beset by redundancies. Russian regulatory bodies generally refuse to accept foreign testing centers' data or certificates. U.S. firms active in Russia have complained of limited opportunity to comment on proposed changes in standards or certification requirements before the changes are implemented, although Russian standards and certifications bodies have begun to work closely with the American Chamber of Commerce in Russia to provide relevant information. Occasional jurisdictional overlap and disputes between different regulatory bodies compound certification problems. In 1998, the Russian Government made operational its inquiry point for regulations covered by the Technical Barriers to Trade (TBT) agreement in the World Trade Organization (WTO). On July 31, 1998, new amendments to Russia's law on certification of products and services went into effect which generally meet requirements of the TBT agreement. The law allows for manufacturer declaration of conformity for a limited number of products. However, this option is not yet available in practice.

The current Russian product certification regime makes it difficult to get products into the Russian market and creates barriers to Russian exports as well. Manufacturers of telecommunications equipment, construction materials and equipment, and oil and gas equipment continue to report serious difficulties in obtaining product approvals. Certification is a particularly costly and prolonged procedure for telecommunications equipment. Telecom equipment is tested for compliance with standards established by both Gosstandart and the State Committee on Communications (Gostelkom). This process typically takes 12-18 months. Self certification by manufacturers is currently not possible. Order 113, introduced by Gostelkom in July 1998, requires all mobile communications systems in Russia to convert to the Russian glonass system by July 1999. This will require costly reconfiguration of systems by U.S. telecommunications companies to maintain access to the Russian market.

Requirements of the Russian Veterinary Department are burdensome and sometimes of questionable scientific or food safety value. As Russia looks to WTO accession, the Veterinary Department will need to develop a more transparent, science-based and WTO-consistent food inspection system. In 1998, biotech food products attracted the attention and increased scrutiny of Russian import authorities. Selected products were required to undergo private-sector-funded government tests in order to maintain necessary certification to remain on the market. Companies were required to fund food safety studies of questionable merit conducted by the Institute of Nutrition in order to receive necessary certification from the Health Ministry. In late 1998, the interministerial government commission responsible for issues related to genetic engineering began to form working groups to examine issues related to biotech including food safety.

Technical level discussions on phytosanitary import requirements for planting seeds have resulted in a positive change in the Russian Government position, making it possible to import U.S. corn and soybean seeds.

Russian agencies have begun requiring use of holographic marks of conformity on a small number of goods and on copies of certification documents. Foreign businesses have complained that the requirement is costly and unnecessary, involves unclear rules, and that Gosstandart has not coordinated sufficiently with the Customs Service.

GOVERNMENT PROCUREMENT

The Russian Government has virtually eliminated the Soviet practice of centralized imports through state-owned foreign trading companies. Some large-scale trade deals for state needs (such as a recent food for natural gas debt deal between Russia and Belarus) still take place. Typically, however, the government awards the right to implement such deals on its behalf to private or quasi-private trading houses.

Russian ministries and government agencies are frequent purchasers of equipment, goods and services for their own needs or for the needs of various domestic organizations or groups (i.e., the military, regional health organizations, or population centers located in remote areas). In April 1997, the government established procedures for public tenders for some government procurement. A government procurement bill, based on competitive bidding, is also being considered in the Duma. Domestic suppliers currently are not accorded many official advantages or privileges in competing for government procurement. Nonetheless, the Russian government's strong political bias toward supporting domestic industries may work in favor of Russian suppliers. An example of such bias occurred in 1997 when government agencies were directed to use only domestic automobiles (a program which ran into problems and is currently not strictly enforced).

On January 13, 1999, an amendment to the Federal Law on Communications went into effect , which appears to vaguely exhort government agencies purchasing communications equipment in efforts to give priority to systems using Russian- produced equipment. The impact on U.S. exports will depend on implementation of the new law; U.S. companies are not currently expecting a large impact.

EXPORT SUBSIDIES

The Russian government's industrial policy guidelines emphasize export promotion and import substitution. In practice, there has been limited budgetary funding for such projects, and the programs that do exist are designed to provide support to industries which export, rather than targeted export subsidies. Russia has no explicit export subsidies on agricultural products.

LACK OF INTELLECTUAL PROPERTY PROTECTION

Estimated losses to U.S. industry due to intellectual property piracy exceeded one billion dollars in 1998, according to industry sources. During the summer of 1998, the U.S. motion picture industry estimates that video piracy in Russia rose by 20-30 percent to approximately 80 percent, in the aftermath of the financial crisis.

With the exception of retroactive protection of copyrights, the Russian Government has made considerable progress in constructing a legal framework to bring Russia up to world standards in the area of intellectual property protection. Since 1992, Russia has enacted generally acceptable laws on trademarks and appellations of origins, patents, and protection of semiconductor chips, computer software, and copyrights. Russia is a member of the Paris Convention, the Universal Copyright Convention and other major multilateral intellectual property conventions. In 1995, Russia acceded to the Berne and Geneva Conventions. The U.S.-Russia bilateral trade agreement also requires Russia to provide protection for intellectual property. Russia is in the process of joining the WTO, and as a new member will be required to meet obligations under the WTO’s Trade Related Aspects of Intellectual Property Rights (TRIPs) immediately upon accession.

U.S. industry remains very concerned by the lack of effective anti-piracy action by Russian law enforcement agencies. Strengthened criminal penalties for IPR infringement went into effect January 1, 1997. But, while the Russian Government has begun to pay more attention to enforcement, there are still disappointingly few cases in which these penalties have been applied. As the estimated losses attest, piracy of U.S. video cassettes, films, music recordings, books, and computer software is extensive in Russia. Some U.S. companies have had difficulty registering well-known marks. Administrative and judicial review bodies are only beginning to become active in IPR protection. The U.S. industry believes that at the prosecutorial and judicial levels, officials often do not consider copyright infringements to be serious offenses and thus do not issue appropriate levels of penalties.

U.S. investors also consider the Russian court system to be unprepared to handle sophisticated patent cases. However, a higher patent chamber has been established at the Russian Patent and Trademark Agency which should bring greater expertise and efficiency to resolution of trademark and patent disputes.. The U.S.-Russia bilateral trade agreement calls for a side letter on mutually acceptable provisions on compulsory licensing. The text of a letter was agreed upon in September 1997, however the Russian Government has not signed the side letter.

SERVICES BARRIERS

Discrimination against foreign providers of non-financial services are not so much the result of federal law, as abuse of power, sub-national regulations, and practices that may even violate Russian law. For example, foreign providers of services have sometimes noted discrimination in obtaining licenses from local authorities and often pay fees many times more than those paid by domestic companies.

The federal law on "Banks and Banking Activity of 1996" permits foreign banks to establish branches or subsidiaries in Russia. The law allows the Central Bank to impose a ceiling on the total amount of foreign bank capital as a percentage of the total bank capital in Russia. Foreign banks' share of the total capital is around 4 percent, well below the current 12 percent ceiling. In May 1997, the CBR announced new regulations requiring foreign banks to have a minimum of ECU10 million (about USD 11.5 million) in capital and to have at least 75 percent of its employees and 50 percent of its management board of Russian nationality. Heads of Russian offices in foreign banks are required to be proficient in the Russian language. In early 1998, the Russian Government enacted insurance law amendments which will prevent foreign-licensed insurers from insuring the property of Russian companies and individuals. Foreign insurers are now limited to re-insurance and mutual insurance for Russian companies. Foreign firms can hold 49 percent stakes in joint ventures with Russian insurers. However, a draft bill pending in the legislature seeks to impose a 15 percent cap on foreign ownership in this sector, as a whole. In 1998, firms with foreign capital encountered difficulties in offering travel insurance coverage.

In October 1998, the President vetoed draft Russian legislation that would have limited market access for foreign investors in the tourism sector. However, supporters of the bill may try to override the veto or to redraft parts of the bill in order to gain government support.

New tax regulations went into effect January 13, 1999, that provide tax breaks to the Russian film industry until January 1, 2001. Contracts for production, printing and showing of Russian movies (which include the sale of copyrights) will be exempt from the 20 percent value added tax. To qualify as Russian movies, a film must be produced and directed by Russian citizens/companies, have foreign investment of no more than 30 percent and use a crew made up of no more than 30 percent foreign nationals. Fifty percent of the budget must be spent in Russia, and the film must use the Russian language or another language spoken in the Russian Federation. Investments in film production, distribution, and the construction and refurbishment of movie theaters, will be exempt from the profit tax. According to press reports, the draft 1999 budget also allocates 264 million rubles (about USD 12 million) for direct support to the film industry.

INVESTMENT BARRIERS

A Bilateral Investment Treaty (BIT) was signed between the United States and Russia in June 1992. The treaty was approved by the U.S. Senate in October of the same year, but it will not enter into force until approved by the Russian Duma.

Foreign investors in Russia have indicated their greatest concern is the legal system, particularly shareholders' rights and weak contract law. Some court decisions that favor western investor have not been implemented. In addition, as projects generally require federal, regional and local approval, the vagueness of existing laws causes different interpretations and conflicting requirements at the different levels. In 1997, the Prime Minister created an Interministerial Commission on Shareholders Rights to improve government coordination in dealing with investment disputes.

Failure to pass a federal land code that allows purchase and sale of real property has posed problems for investors in some regions of Russia. This controversial bill has been stymied for five years by the Duma's objections to private ownership, buying and selling of farmland, and fears that land holdings will be concentrated in a small number of hands. Despite many hopes, the latest version of the law was rejected by the Duma, on December 23, 1998. The Duma must now redraft the legislation and pass it through three readings. Some regions are moving to allow land ownership and sale within their own borders, including Saratov, Samara and the city of Moscow. These local developments may mitigate the problems related to real estate holdings for foreign investors.

Economic disincentives are also a key concern foreign investors, particularly with regard to the Russian tax system. Under Present legislation in Russia, businesses rather than individuals carry the brunt of the tax burden. Russia's draft tax code attempts to address this and other problems; if passed in full, it should simplify the tax system and in some cases reduce the overall tax burden on businesses operating in Russia. Part I of the tax code was passed in July 1998; the legislature is currently considering part II, which will define the rates for specific taxes. Crime and corruption in commercial transactions and problems with the implementation of customs regulations also inhibit investment.

In December 1998, the Russian Duma passed the long-awaited amendments to the Production Sharing Agreement Law. The amendments were signed into law on January 8. These bills are considered necessary prerequisites to large-scale investment in the Russian oil and gas sectors, although conditions in the world oil market may limit the amount of new investment in the near term. The new legislation increases the local-content requirement for equipment to 70 percent and requires 80 percent local labor. There is no reference to the period in which these targets must be achieved, and U.S. companies believe they will be workable provided that subsequent regulations are written in an appropriately flexible way by the Government of Russia.

Regarding purely financial disincentives, most foreign investors cite concerns about profit repatriation. This is especially true with regard to ongoing negotiations to restructure Russia's domestic debt, after a default in August 1998 brought on by the financial crisis. Although Russia assumed obligations under article VIII of its IMF Treaty to permit the free flow of capital, the Central Bank has gradually been imposing increasing controls on capital flows. Such measures include increasing the percentage of export proceeds which must be repatriated (from 50 to 75 percent) and decreasing the time for repatriation (from 14 to 7 days). The Central Bank has also instituted dual foreign currency trading sessions, with a special session in the morning for importers and an afternoon session for "speculators." There has been some divergence in exchange rates between the two sessions.

For those investors interested in exporting their product overseas, temporary export taxes adopted in January 1999, as revenue measures designed to capture a portion of the windfall profits from the devaluation of the ruble, may also act as a disincentive. Ten percent export tariffs are levied on the export of scrap from seven metals - copper, nickel, aluminum, lead, zinc, cobalt and titanium - as well as sunflower seeds, rapeseed, soybeans, raw hides and tanned leather, and certain logs (oak, beech, ash). A five percent export tax will be levied on natural gas, refined copper and copper products, nickel ore, nickel and nickel products and fuel oil. The government is also considering a five percent export tax on crude oil exports. The fact that Russia collects VAT on exports at the point of sale in Russia means that these Russian-sourced exports to other countries which collect VAT from the final customer are burdened with a double VAT tax burden.

In July 1998, the President vetoed a bill containing amendments to the Russian Law on Foreign Investments. The bill included provisions creating incentives for large projects (which meet certain criteria such as export orientation or import substitution) and has registration requirements for foreign direct investments. The Duma has formed a reconciliation committee to try to rework the law to respond to the President's concerns. In addition, the government is considering proposals to provide tax incentives to large investors.

A Presidential decree signed in early 1998 provides investment incentives for large investments in the auto industry that meet local content requirements. Although the decree is technically still in place, its implementation has been on hold since the onset of the economic crisis. Resolution 1235 of October 1998 allows companies to postpone payment of customs duties and related taxes for up to two years, for products withdrawn from customs warehouses by December 31, 1998. There are no discriminatory aspects to this temporary crisis-relief measure, but these tax benefits may be considered a subsidy under World Trade Organization rules if the beneficiaries export their products.

Aircraft

Russian tariffs on imported aircraft were raised from 15 to 50 percent in March 1994, and then lowered to the still prohibitive level of 30 percent in 1995. On January 30, 1996, Vice President Gore and Russian Prime Minister Chernomyrdin concluded a joint Memorandum of Understanding (MOU) that addresses U.S. concerns about barriers to the Russian civil aircraft market and the application of international trade rules to the Russian aircraft sector. The MOU states that U.S. aircraft manufacturers will be able to participate in the Russian market and share in its growth. The MOU also makes clear that the Russian aircraft industry will in time be fully integrated into the international economy. Russia pledged to undertake the same international trade principles as the United States and many others.

In the interim before Russia accepts its full international trade obligations, the MOU commits Russia to take steps, such as the granting of tariff waivers, to enable Russian airlines to meet their needs for non-Russian aircraft on a non-discriminatory basis. On July 7, 1998, the Russian Government issued Resolution 716 which requires Russian airlines to commit to the purchase or lease of Russian made aircraft in order to receive duty reductions and exemptions for foreign aircraft acquisitions. During the course of 1998, tariff waivers were granted to Aeroflot for purchases of foreign aircraft under these conditions.

On January 8, 1998, a federal law on state regulation of the development of aviation was signed. The law stipulates preferential treatment (tax holidays, guarantees on investment) for Russian and foreign investors in aviation-related research and manufacturing ventures. The law limits the share of foreign capital in aviation enterprises to less than 25 percent and requires that board members and senior management staff be Russian citizens.

ELECTRONIC COMMERCE

The Civil Code of the Russian Federation explicitly allows electronic commerce as a form of transaction. According to Russian industry sources, the key legal obstacle is the absence of a government body to provide licenses to electronic commerce businesses that would allow them to issue digital certificates for protection of on-line payments using credit cards. Russian companies hope to convince the State Committee on Communications to accept the role of a licensing body to certify authorities. In the interim, e-commerce transactions are either prepaid or involve payment upon delivery of the goods.